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Transmitted via e-mail

January 24, 2011

Mr. Samuel P. Schuchat, Executive Officer
California State Coastal Conservancy
1330 Broadway, 13th Floor
Oakland, CA 94612-2530

Dear Mr. Schuchat:

Final Report—Audit of California State Coastal Conservancy's Propositions 12, 13, 40, and 50 Bond Funds

The Department of Finance, Office of State Audits and Evaluations, has completed its audit of the California State Coastal Conservancy's (Conservancy) Propositions 12, 13, 40, and 50 bond funds for the period ending June 30, 2008.

The Conservancy's response to the report observations and our evaluation of the response are incorporated into this final report. As requested in the draft report and based on our evaluation of the Conservancy's response, the Conservancy is required to submit a detailed corrective action plan addressing Finding 1. This corrective action plan should be submitted within 60 days from the date of this transmittal.

Please mail your corrective action plan to:

Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

In accordance with Finance's policy of increased transparency, this report will be placed on our website. Additionally, pursuant to Executive Order S-20-09, please post this report in its entirety to the Reporting Government Transparency website at <http://www.transparency.ca.gov/> within five working days of this transmittal.

We appreciate the assistance and cooperation of the Conservancy. If you have any questions regarding this report, please contact Diana Antony, Manager, or Beliz Chappuie, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Mr. Neal Fishman, Deputy Executive Officer, California State Coastal Conservancy
Ms. Nadine Hitchcock, Deputy Executive Officer, California State Coastal Conservancy
Ms. Regine Serrano, Chief of Administrative Services, California State Coastal Conservancy
Mr. Patrick Kemp, Assistant Secretary, Natural Resources Agency
Mr. Bryan Cash, Deputy Assistant Secretary, Natural Resources Agency
Ms. Julie Alvis, Deputy Assistant Secretary, Natural Resources Agency

AN AUDIT OF BOND FUNDS

California State Coastal Conservancy Propositions 12, 13, 40, and 50



Source: California State Coastal Conservancy Website

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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Final reports are available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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EXECUTIVE SUMMARY

In accordance with the Department of Finance's (Finance) bond oversight responsibilities, we audited the California State Coastal Conservancy's (Conservancy) funding under Propositions 12, 13, 40, and 50 as of June 30, 2008. The audit objectives were to determine whether bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and to determine if the Conservancy had adequate project monitoring processes in place. We identified the following control and accountability issues requiring corrective action.

- Since 2001 the Conservancy issued approximately \$13 million in bond-funded loans without clear authority or adequate controls. Additionally, approximately \$2.9 million in loan repayments have been received and deposited in the Conservancy Fund, which is used for general operations and support funding.
- The Conservancy did not establish formal program guidelines; project awarding criteria; and grant applications to document its project merit review process. Also, the Conservancy website included limited or incomplete information about ongoing programs and efforts, regional priorities, and funding opportunities. Subsequent to our audit, the Conservancy made efforts to address some of these issues.
- The Conservancy's fiscal oversight and monitoring of bond funds needs improvement. Specifically, project scopes and budgets lack detail, match contributions are not enforced, grantees are paid for non-budgeted items, and project monitoring is inconsistent and inadequately documented.
- Bond project status is incomplete and does not fully comply with bond reporting requirements. To address this observation, the Conservancy is developing the Coastal Conservancy Project Management Database to track its projects.

The recommendations in this report are intended to assist management in improving operations and accountability for bond funds.

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

Between March 2000 and November 2002, California voters passed the following four bond measures totaling \$10.1 billion:

- Proposition 12—The Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000
- Proposition 13—The Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act
- Proposition 40—The California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002
- Proposition 50—The Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002

These propositions authorized the sale of bonds to finance a variety of resource programs. Administered by a number of state departments, agencies, boards, and conservancies, the proceeds from these bonds support a broad range of programs that protect, preserve, and improve California's water and air quality, open space, public parks, wildlife habitats, and historical and cultural resources. Bond proceeds are expended directly by the administering departments on various capital outlay projects, and are also disbursed to federal, state, local, and nonprofit entities in the form of grants, contracts, and loans.

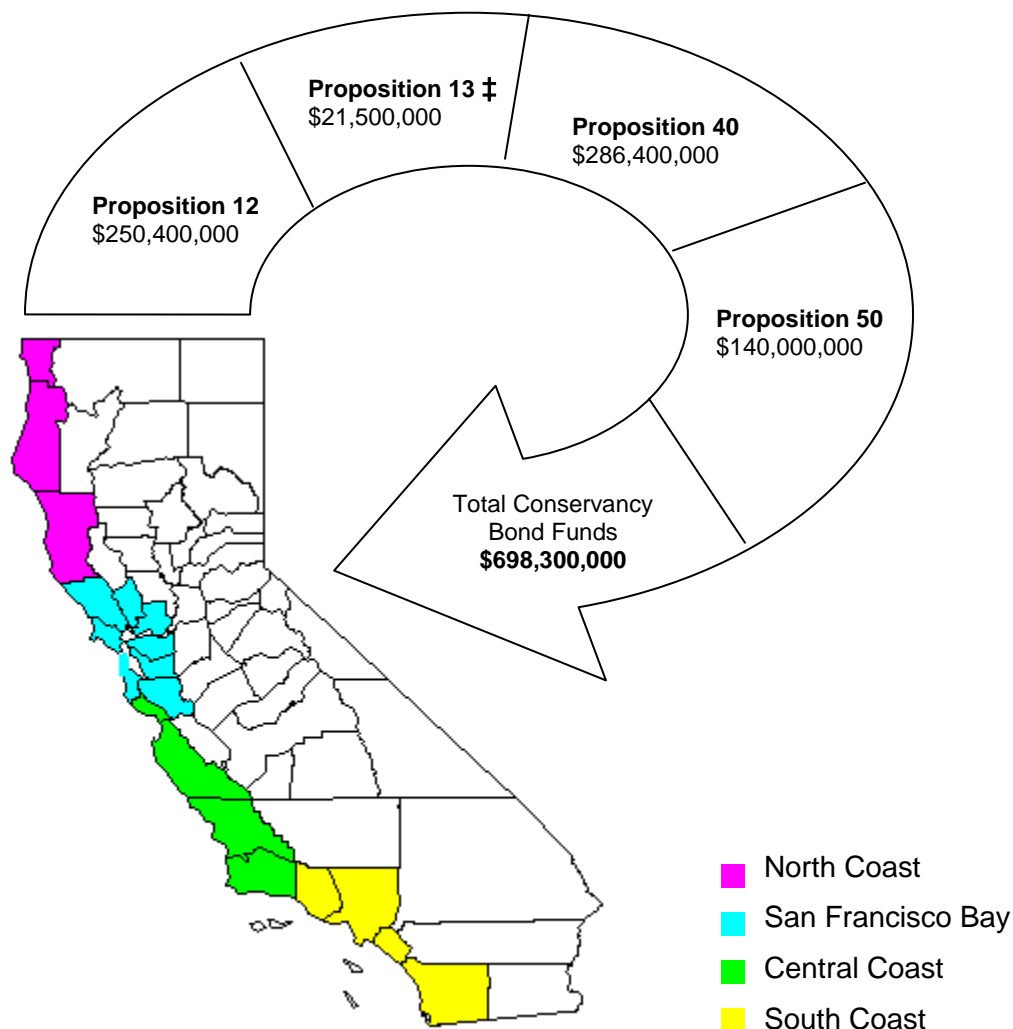
California State Coastal Conservancy

The California State Coastal Conservancy (Conservancy) was established in 1976 through Division 21 of the Public Resources Code. The Conservancy's mission is to act with others to preserve, protect, and restore the resources of the California coast, ocean, and the San Francisco Bay Area. Their vision is of a beautiful, restored, and accessible coastline, ocean and San Francisco Bay Area. The Conservancy Board's seven members are appointed by the Governor and California Legislature. The Legislative Oversight Committee meets with the board and participates in its activities. The committee is made up of three members of the Senate and three members of the Assembly.

The Conservancy staff of 77 consists of executive management, program and project managers, legal, and administrative staff. There are four regional program managers directing a staff of 34 project managers, who are responsible for initiating and developing the projects, selecting the grantee and then managing the projects.

In total, the Conservancy administers over \$698.3 million in allocated bond funds over four primary state regions as shown in Figure 1.

Figure 1. Propositions 12, 13, 40, and 50 Funds Allocated to the Conservancy as of June 30, 2008



Source: Propositions 12, 13, 40, and 50 Bond Acts.

Notes:

† A specific allocation amount of Proposition 13 Bond funds for the Conservancy was not identified. The Conservancy received Proposition 13 funding through the Department of Water Resources' allocation.

Bond Funded Projects

The Conservancy awarded bond funds to various types of projects as defined in the bond act and Conservancy's enabling legislation. These projects are grouped in the four program areas defined in the Conservancy's strategic plan:

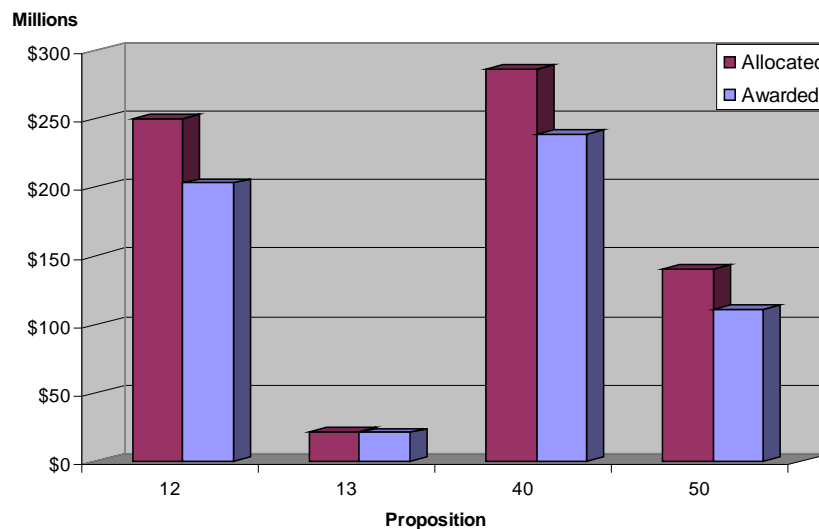
1. Public accessways (to and along the shore)—construction of new facilities, repairs to existing facilities, acquisition of land or offers to dedicate real property, development of the coastal trail, and waterfront development and repair.

2. Resource conservation—land acquisitions, natural resource restoration and enhancement, land use conflict resolution, and watershed restoration.
3. San Francisco Bay area conservation—construction of public accessways, natural resource restoration and protection, acquisition of open space and agricultural conservation easements.
4. Ocean program—protection of ocean and coastal resources.

These main program areas are further subdivided into nine sub-programs that correspond to chapters in the enabling legislation and the Ocean Program (see Appendix A).

The Conservancy has awarded \$567 million (81 percent) of the \$698.3 million allocated from Proposition 12, 13, 40, and 50 as shown in Figure 3.

Figure 3. Bond Funds Allocated* and Awarded as of June 30, 2008



Source: Bond acts and the Conservancy's accounting records.

Notes: *Amounts include statewide costs.

SCOPE

The audit was conducted to determine whether Proposition 12, 13, 40, and 50 bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and to determine if the Conservancy has adequate project monitoring processes in place. Proposition 84 funds were not included in this audit; however, several programs audited will be receiving Proposition 84 funding. Therefore, because we tested the controls and processes in place for awarding and monitoring under the current programs, the observations and recommendations may be applicable to Proposition 84 programs.

Our review did not include an assessment of the bond authorization, issuance, and sale processes, or an examination of the efficiency or effectiveness of program operations. Further, no assessment was performed on the reasonableness of the land acquisition costs or the conservation value of acquired land or projects completed.

METHODOLOGY

To determine whether bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and whether the Conservancy had adequate monitoring processes, we performed the following procedures:

- Reviewed applicable bond acts and Conservancy's grant management policies, procedures, including the strategic plan and other legal provisions and regulations.
- Interviewed key personnel responsible for administering bond funds to obtain an understanding of how the Conservancy oversees various project stages: pre-award, award, interim monitoring, closeout, and post-close monitoring.
- Examined a sample of project files to determine if the projects stayed within scope and cost. The sample of projects was selected from two sub-programs; System of Public Accessways and Coastal Resource Enhancement, which represent 52 percent of total bond awards (see Appendix B for list of projects tested).
- Performed nine separate Conservancy grant audits (See Appendix C for list and link to audit reports).
- Identified and assessed the project tracking methods to determine its adequacy for monitoring projects.
- Reviewed a sample of expenditures to verify accuracy of recorded and reported financial information.
- Reviewed the reasonableness of Conservancy's administrative expenditures charged to bond funds.

Multiple discussions were held with the Conservancy throughout our audit fieldwork to discuss and provide specific project review details. Recommendations were developed based on interviews with Conservancy management and key staff directly responsible for administering bond funds and review of documentation made available to us. This audit was conducted during the period December 2008 through April 2009.

Except as noted, this audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. In connection with this audit, there are certain disclosures required by *Government Auditing Standards*. Finance is not independent of the audited entity, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

The audit identified the following observations requiring corrective action. As noted in the Scope section of this report, although this audit did not include Proposition 84 funding, several programs audited received Proposition 84 funds. Consequently, the following observations and recommendations may also pertain to Proposition 84 programs.

Observation 1: Lack of Accountability Over Bond-Funded Loans

The Conservancy issues bond-funded loans without clear authority or adequate controls. Specifically, the Conservancy's funding agreements include repayment clauses specifying amounts due by a certain date(s); however, the Conservancy classifies these as "grants with repayments" instead of loans. Because loan authority is vested in the legislature (or other rule making body) the Conservancy should cite or obtain legislative authority. In accordance with generally accepted budgetary and accounting principles, we interpret these as loans. The following control weaknesses were noted:

Loan Receivables are Not Recorded

Since 2001 the Conservancy issued approximately \$13 million in bond-funded loans without properly recording the outstanding receivables. Although short-term receivables are recorded in the Conservancy Fund (Fund 0565) when the first payment is due, that date in some cases can be as long as 10 years. During that time, the amounts due are manually tracked by contract managers and not recorded in the Conservancy's accounting system.

Based on Conservancy grant audits performed by Finance in March 2010¹, loan repayment terms were inconsistently and inadequately enforced. In two cases, the loan repayments for a \$300,000 loan and a \$2,000,000 loan were late by over three years and three months, respectively.

The State Administrative Manual (SAM) section 7622 establishes Account No. 2100, Loans and Advances Receivable, as the summary account of long-term loans and advances receivable. The loan accounting entries will depend on the legal authority for the loan, the type of funds involved, and whether the loan will cross fiscal years.

Loan Repayments Recorded as Revenues in Conservancy Fund

Loan repayments are recorded as revenues in Fund 0565 instead of the bond fund of origin. According to the Conservancy, approximately \$2.9 million in loan repayments have been received and deposited in Fund 0565. The Conservancy uses Fund 0565 for general operations and support funding.

The Conservancy claims Public Resources Code section 31011 requires it to remit all "funds received" to Fund 565 and establish separate accounts within the fund. However, Government Code section 16303 requires moneys subsequently returned to be credited to the originating appropriation and fund.

¹ See Appendix C for list and link to separately issued grant audit reports.

Therefore, bond loan repayments should be deposited into the bond fund of origin. Additionally, the Conservancy never established separate accounts in Fund 0565 precluding effective identification of bond funds. Because the Conservancy uses Fund 0565 for support-type costs, bond funds are at risk of misuse. For example, during Finance's March 2006 Conservancy bond audit, bond funds were directly charged over \$37,000 in ineligible supports costs, including over \$10,000 for yoga classes. The Conservancy subsequently repaid the bond funds and moved the costs to Fund 0565.

Proper internal accountability is required to ensure bond funds are separately tracked for future use, reappropriation, or other disposition by the Legislature. Generally accepted budgetary and accounting principles require loan repayments to be deposited into the same fund from which the original loans were made. Without proper recording of loan receivables and repayments, the bond funds are at risk of misappropriation and misuse.

Recommendations:

- A. Cite or obtain legislative authority and develop and implement a loan program accordingly.
- B. Identify and document all outstanding bond loan receivables. Record bond loans as receivables in the Conservancy's accounting system in accordance with SAM section 7622. Maintain supporting documentation for these amounts.
- C. Record bond loan repayments in the bond fund of origin. Discontinue depositing bond loan repayments in Fund 0565. Transfer prior bond loan repayments from Fund 0565 to the bond fund of origin. Maintain supporting documentation for these amounts.
- D. Provide a detailed Corrective Action Plan addressing the findings and recommendations within 60 days from the date of this report. The corrective action plan should include milestones and target dates to correct all deficiencies.

Observation 2: Project Awarding Process Needs Improvement

As of June 30, 2008, the Conservancy awarded \$567 million in bond funds without established formal program guidelines, specific project awarding criteria, project application forms, or website announcements in place.

The Conservancy does not utilize program specific guidelines and criteria to award bond funds as required by the bond act, the Public Resources Code Division 21, and the Conservancy's enabling legislation. Instead, the Conservancy uses its Strategic Plan as its basis to fund all projects while considering applicable local plans; however, the Strategic Plan is broad and reflects only general requirements applicable to all projects.

General Criteria Used by the Conservancy

- *Promotion of the Conservancy's statutory programs and purposes*
- *Consistency with purposes of the funding source*
- *Public support*
- *Location (must benefit coastal, ocean resources, or the San Francisco Bay region)*
- *Need (desired project or result will not occur without Conservancy participation)*
- *Greater-than-local interest*

Source: Strategic Plan

Additionally, the Conservancy does not have a formal awarding process or a grant applications process to document its project merit review. Without bond-specific program criteria and application review documentation, the merit for selected projects is not transparent.

In awarding projects, the Conservancy works with the Conservancy's partners—public agencies and nongovernmental organizations—to identify potential projects. However, information on the Conservancy website about ongoing programs and efforts, regional priorities, and funding opportunities is limited. Agendas for upcoming Board meetings do not list projects under evaluation and therefore may limit external opportunities for involvement. Additionally, with 34 Conservancy program staff and 4 regional managers performing project reviews, establishing a formalized awarding process is critical to ensure project consistency.

Public Resources Code, Division 21, sections 31205, 31254, and 31303 require “The Conservancy to request the commission, local public agencies, nonprofit organizations, and other public and private groups to assist in the development of *criteria and guidelines for the submission, evaluation, and determination of priority of projects* (coastal restoration, coastal resource enhancement, and urban waterfront restoration). After considering comments received from such sources and ensuring that adequate opportunity for public review and comment has been provided, the *conservancy shall adopt guidelines and criteria for the administration of the coastal program authorized under this chapter.*”

Water Code section 79505.6 (a) (1) states, by March 15, 2004, each state agency disbursing grants or loans pursuant to this division shall develop project solicitation and evaluation guidelines.

Government Code section 13402 states that state agency heads are responsible for the establishment and maintenance of a system or systems of internal accounting and administrative control within their agencies. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

The Conservancy Strategic Plan states, “The administration, Legislature, academia, interest groups, and the general public need to be informed of programmatic, strategic, and project planning and development, upcoming opportunities for participation, and of the outcomes of these projects and other decisions.”

Subsequent to this audit, the Conservancy recently made several efforts to address some of these issues, including grant applications and project selection criteria posted to its website.

Recommendations:

- A. Develop program specific guidelines and criteria outlining the submission, evaluation, and project priority process and determinations.
- B. Publish the above guidelines and funding opportunities on the Conservancy website.
- C. Document merit review activities clearly indicating how projects meet the program's established awarding criteria.
- D. Provide related staff training.

Observation 3: Project Matching Funds May Not be Maximized

The Conservancy does not enforce or monitor grantees' required match contributions. For 12 projects reviewed, grant budgets and work plans indicated total available match contributions of over \$7.3 million. For example, grant agreements for two of the projects reviewed, California State University at Monterey Bay and City of Pacifica, specifically stated, "Conservancy funds shall not be disbursed until matching funds are committed"; however, the Conservancy never verified the match contribution.

Additionally, although staff project recommendations indicate match contributions, the final grant agreements and work plans do not consistently include the match requirement language. Most state departments require grantees to report match contributions via the reimbursement request forms. This allows the department to monitor and confirm grantee's match contributions. The Conservancy Request for Disbursement form does not require match reporting.

Public Resources Code section 5096.651 requires priority be given to projects with a match contribution. In addition, the Conservancy's 2007 Strategic Plan (see text box above) identified the match need and assumed Conservancy funds would be matched by at least 2 to 1.

Matching Funds Priority

"The Conservancy's recently completed Five-Year Capital Infrastructure Plan for fiscal years 2008-09 to 2012-13 identified a need for approximately two times the dollar amount assumed to be available to the Conservancy. Additionally, like this strategic plan, it also assumes the Conservancy's funds will be matched by at least 2-1."

Source: Conservancy Strategic Plan

Recommendation: Monitor and verify match contributions prior to disbursement. Include a match reporting section in the reimbursement request form and require submission of match documentation.

Observation 4: Project Fiscal Oversight Needs Improvement

The Conservancy lacks adequate project fiscal oversight. Based on a review of 12 projects, the following control weaknesses were noted:

- *Detailed work plans and budgets are not consistently received or documented prior to project commencement.* The Conservancy awards projects based on estimated scope and costs with the condition that detailed work plans and budgets will be submitted and approved prior to commencing project work. However, based on a review of 12 projects, 3 of 12 detailed work plans and 5 of 12 expenditure budgets were missing. Without clearly defined scopes and budgets, the Conservancy's ability to monitor projects and ensure successful completion is at risk.

State Contracting Manual defines scope as, "The work, service, or product to be performed, rendered, or provided. Clear and concise language must be used to describe the scope."

- *Grantee reimbursements are not consistent with grant budgets.* Based on an audit performed by Finance in 2010 of Sonoma Land Trust, Sears Point Grant, the grantee was reimbursed for \$58,862 in overhead costs.

Overhead was not a grant approved budget line item. In addition, the grantee billed and was reimbursed for *budgeted* salary rates instead of *actual* salary cost. Half-way through the contract term, the total markup was \$22,775 over actual costs. (See Appendix C for link to grant audit report.)

Grant agreements require grantees to submit a Request for Disbursement form with supporting documentation. However, the Conservancy allows grantees to use their own invoices, which do not always reflect budgeted items. Consequently, the claimed costs are not consistent with the approved budgets.

- *The Conservancy lacks formal monitoring procedures leading to inconsistent reviews and limited documentation.* Project managers are responsible for performing site visits of restoration, enhancement, and public access projects to ensure projects stay within scope and cost; however, there is no guidance defining required site visit intervals, areas to review, or documentation required.

During the review of the Malibu Lagoon Restoration project, documentation was limited and the project manager was unable to provide adequate justification for the project's eight amendments that modified the scope and increased total funding from \$300,000 to \$925,259. Additionally, although the file included a detailed budget for the initial award, the subsequent amendments included only lump sum amounts providing little to no justification for the 208 percent funding increase. The project manager was not in charge during the amendment approvals.

- *Post-close monitoring is not performed.* Once a project is closed, the post-monitoring requirement is intended to ensure the project is adequately maintained as specified in the grant agreement. Two of four closed projects reviewed lacked a project monitoring plan. The Conservancy acknowledged post monitoring is not being performed or documented on a consistent basis. The Conservancy relies on grantees, other state agencies, or non-profits in the area to alert them about project issues. Although Conservancy grant agreements include early termination for failure to perform and notification in the case of a change in ownership, these are defensive measures. The Conservancy should be proactive. Other state agencies require long-term management plans with periodic condition reports, including site photos.
- *Project status is inaccurate and incomplete.* A comparison of accounting records with reported project status² indicated a difference of over \$172 million in project awards. Public Resources Code section 5096.686 and Water Code section 79575 require annual project and expenditure summary reports. According to the Conservancy, the website has not been updated due to limited staffing resources; however, they are in the process of developing the Coastal Project Management Database to track its projects.

Recommendations:

- A. Develop a standard application with workplan/budget templates including directions on how to complete it. Define the level of detail needed for different project types to ensure consistency among the program staff.
- B. Standardize reimbursement forms to match the approved grant budgets. Include template in program guidelines along with clear definition of eligible costs.

² Project status is posted on Natural Resource Agency's "Proposition 40/50 Awards Website".

- C. Develop and implement monitoring procedures outlining site visit intervals, areas to review, and project documentation required.
- D. Require grantees to submit a maintenance and operation plan at project close-out and require periodic project condition reports.
- E. At year-end, reconcile project database information to accounting records to ensure all bond projects are accurately recorded. Complete the Coastal Project Management Database and update the website accordingly.
- F. Provide related staff training.

California State Coastal Conservancy's Sub-Programs

Public Resources Code section	Program Name	Program Purpose
31119(a)	Coastal Education	To undertake educational projects for pupils in kindergarten to grade 12, relating to the preservation, protection, enhancement, and maintenance of coastal resources.
31150-31156	Preservation of Agricultural Lands	For the purpose of acquiring fee title, development rights, easements, or other interests in land and undertaking improvements to and development of lands located in the coastal zone in order to prevent loss of agricultural land to other uses and to assemble agricultural lands into parcels of adequate size permitting continued agricultural production. All feasible action will be taken to return to private use or ownership all lands acquired, with appropriate use restrictions.
31160-31165	San Francisco Bay Area Conservancy Program	<p>The Conservancy may undertake projects and award grants to the nine counties of the San Francisco Bay Area that will help achieve the following goals:</p> <ul style="list-style-type: none"> • To improve public access to, within, and around the bay, coast, ridgetops, and urban open spaces, without having a significant adverse impact on agricultural operations and environmentally sensitive areas and wildlife through completion and operation of regional bay, coast, water, and ridge trail systems, and local trails connecting to population centers and public facilities, and through preservation of related facilities. • To protect, restore, and enhance watersheds, scenic areas, natural habitats, connecting corridors, and other open-space resources of regional importance. • To assist in the implementation of the policies and programs of the California Coastal Act of 1976, the San Francisco Bay Plan, and other adopted plans. • To promote, assist, and enhance projects that provide open space and natural areas that are accessible for recreational and educational purposes.
31200-32215	Coastal Restoration Projects	For the purpose of restoration of areas of the coastal zone that, because of scattered ownerships, poor lot layout, inadequate park and open space, incompatible land uses, or other conditions, are adversely affecting the coastal environment or impeding orderly development. Grants shall be utilized to assemble parcels of land within designated coastal restoration areas, for the redesign of those areas, and installation of public improvements required for those areas.
31220	Integrated Coastal and Marine Resource Protection	To improve and protect coastal and marine water quality and habitats, the Conservancy may undertake coastal watershed, coastal and marine habitat water quality, sediment management, and living marine resources protection and restoration projects. In consultation with the State Water Resources Control Board, the Conservancy will develop projects consistent with Public Resources Code section 30915, which provides approval for projects that restore and protect the water quality and environment of coastal waters, estuaries, bays, and near shore waters.
31251-31270	Coastal Resource Enhancement Projects	For the purpose of enhancement of coastal resources that, because of indiscriminate dredging or filling, improper location of improvements, natural or human-induced events, or incompatible land uses, have suffered loss of natural and scenic values. Assembly of parcels of land is used to improve resource management, relocation of improperly located or designed improvements, and for other corrective measures to enhance the natural and scenic character of the areas.
31300-31316	Urban Waterfront Restoration	To promote the restoration of the state's vital urban waterfronts by developing environmentally sound areas through the creation of parks, open space, visitor serving facilities, and housing for all income levels will promote tourism, public access, and private sector development.
31350-31356	Reservation of Significant Coastal Resource Areas	The Conservancy is vested with the authority to acquire, hold, protect, and use interests in key coastal resource lands to assure coastal resource sites shall be reserved for public.
31400-31410	System of Public Accessways	To implement a system of public accessways by acquiring land or any interest therein, or to develop, operate, or manage lands for public access purposes to and along the coast.
35500-35650	California Ocean Protection Act	To ensure that California maintains healthy, resilient, and productive ocean and coastal ecosystems for the benefit of current and future generations.

APPENDIX B

List of Projects Reviewed at State Coastal Conservancy

#	Grantee Name	Project Name	Amount	Program	Public Resources Code
1	California State University Monterey Bay Foundation	Santa Barbara Channel Marine Mapping Project	\$400,000	Integrated Coastal and Marine Resource Protection	Division 26 Chapter 1
2	Cambria Community Services District	East West Ranch Coastal Trail Improvements	\$345,000	System of Public Accessways	Division 21 Chapter 9
3	City of Malibu	Malibu Civic Center Stormwater Improvement Project	\$1,000,000	Resource Enhancement	Division 21 Chapter 6
4	City of Pacifica	San Pedro Creek Watershed: Capistrano Bridge Fish Passage Improvements	\$545,000	Resource Enhancement	Division 21 Chapter 6
5	County of Humboldt	Humboldt Fish Passage Improvement Program	\$594,272	Resource Enhancement	Division 21 Chapter 6
6	County of Santa Barbara	Isla Vista Beach Accessway Improvements (stair reconstruction)	\$250,000	System of Public Accessways	Division 21 Chapter 9
7	Gold Ridge Resource Conservation District	Salmon Creek Ranch Implementation	\$610,000	Resource Enhancement	Division 21 Chapter 6
8	Mendocino Land Trust	Mendocino Coastal Trail Program, Phase 1	\$200,000	System of Public Accessways	Division 21 Chapter 5
9	Peninsula Open Space Trust	Pillar Point Bluff Coastal Trail	\$433,550	System of Public Accessways	Division 21 Chapter 9
10	Resource Conservation District of the Santa Monica Mountains	Malibu Lagoon Restoration	\$4,316,800	Resource Enhancement	Division 21 Chapter 6
11	Smith River Alliance, Inc.	Mill Creek Implementation Phase I	\$1,000,000	Resource Enhancement	Division 21 Chapter 5.5
12	Sonoma Land Trust	Estero Americano Nature Preserve Enhancement	\$45,965	Resource Enhancement	Division 21 Chapter 5.5
		Total	\$9,740,587		

APPENDIX C

List of State Coastal Conservancy Grant Audits*

#	Grantee Name	Project Name	Amount
1	City of Pacifica	San Pedro Creek Watershed: Capistrano Bridge Fish Passage Improvements	\$545,000
2	City of San Clemente	San Clemente Pedestrian Beach Trail	\$500,000
3	Sonoma Land Trust	Cedars Area Conservation Plan	\$23,000
4	Sonoma Land Trust	Roche Ranch Acquisition	\$3,000,000
5	Sonoma Land Trust	Sears Point Restoration Projects Enhancement and Restoration Plans	\$1,000,000
6	Sonoma Land Trust	Sonoma Bay Lands Trail Facilities and Site Management	\$567,138
7	Monterey Peninsula Regional Park District	Palo Corona Ranch Acquisition	\$12,220,0000
8	Santa Clara County Open Space Authority	Blair Ranch Acquisition	\$4,340,000
9	City of Pacifica	Mahoney Property Acquisition	\$1,100,000
		Total	\$23,295,138

* All final grant audit reports posted at http://www.dof.ca.gov/osae/prior_bond_audits/.



October 7, 2010

Mr. David Botelho, CPA
Chief, Office of State Audits and Evaluations
915 L Street
Sacramento, CA 95814-3706

RE: An Audit of State Bond Fund – California State Coastal Conservancy Propositions 12, 13, 40,
and 50

Dear Mr. Botelho:

This is the California State Coastal Conservancy's ("Conservancy's") official response to the above referenced audit report. We found few surprises in the document, having had numerous conversations with your staff during the audit process. We appreciated their openness and professionalism. While we have disagreements about some of the report's conclusions and recommendations; in several areas we are in general agreement and have either begun or completed corrective actions. We respond below to the report as it is organized, with brief overall comments on the four major issues described in the Executive Summary, and with longer discussions for specific issues and recommendations.

Executive Summary Observations

Observation 1: The Conservancy has made loans without proper authority and has deposited returned funds into the Coastal Conservancy Fund instead of the bond fund of origin.

Response to Observation 1: There is specific unambiguous language in Division 21 of the Public Resources Code authorizing the Conservancy to seek repayments of grants (Public Resources Code section 31118). The same legislative bill through which that statute enacted was enacted also amended section 31101 to require that funds received by the Conservancy be deposited in the State Coastal Conservancy Fund (Fund 0565).

Observation 2: The Conservancy does not have formal program guidelines; project awarding criteria; and grant applications. The Conservancy's website has limited or incomplete information about ongoing efforts, regional priorities, and funding opportunities.

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Oakland, California 94612-2512
510-286-1015 Fax: 510-286-0470

Mr. David Botelho, CPA
October 7, 2010

Response to Observation 2: The Conservancy has had project selection guidelines for many years and periodically updates them. In response to the audit, the Conservancy has recently standardized its grant application among its regions. The Conservancy website has been updated to include the standardized grant application, more information about funding opportunities, and additional information about ongoing efforts will be added. In addition, the Conservancy has a Strategic Plan (Plan) that has been posted on its website and guides the development and funding of projects according to the Plans' goals.

Observation 3: Fiscal oversight and monitoring of bond funds needs improvement. Project scopes and budget lack detail, match contributions are not enforced, grantees are paid for non-budgeted items, and project monitoring is inconsistent and inadequately documented.

Response to Observation 3: We disagree that there is an endemic problem with the detailing of project scopes and budgets or paying for non-budgeted items. The audit is vague about the nature of this assertion and any problems that have arisen.

Non-budgeted items: The Conservancy does not pay invoices unless they are consistent with a work program and budget in the corresponding grant-agreement file. This issue identified in this audit appears to arise from a particular project in which a negotiated overhead rate was authorized but was not sufficiently documented in the agreement. This was a rare occurrence and in no way resulted in inappropriate use of funds.

Matching funds: The auditors misunderstood the nature of matching funds. For most projects the Conservancy did not require specific matching amounts, only that the project had sufficient resources for completion. Thus, there were no specific matching requirements to be enforced.

Project monitoring: We are improving post-project monitoring. The Conservancy has developed standardized post-project monitoring requirements that can be tracked and recorded in the Conservancy's project database and will begin staff training to implement its post project monitoring program this fall.

Observation 4: Bond project status is incomplete and does not fully comply with bond reporting requirements.

Response to Observation 4: We have developed a process for project managers to document project status when processing invoices. We are working to complete all required bond reporting.

Detailed Observations and Responses

Observation 1: Lack of Accountability Over Bond-Funded Loans: The Conservancy issues loans without clear authority or adequate controls. The Conservancy classifies its loans as "grants with repayments." These are actually loans made with unclear authority.

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Detailed Response: Chapter 1551, Statutes of 1984, in adding Public Resources Code section 31118 to the Conservancy's enabling legislation, clearly authorizes the Conservancy to "seek repayments of funds granted pursuant to this division on terms and conditions as it deems appropriate to carry out the provisions of this division." Conservancy staff worked directly with the author of the bill on this and other provisions it contained. The purpose of this section of law is to authorize the Conservancy to make its grants repayable when warranted. This practice, as carried out by the Conservancy over the years since is clearly authorized, and no additional authorization is needed.

Loan Receivables are Not Recorded: Repayable grants should be considered loans and should be recorded within the Conservancy's accounting system. Loans are currently tracked by contract managers not the accounting department. This has led to some loan repayments becoming overdue.

Detailed response: The payback provisions in some grants do not make them loans requiring that they be recorded as loans receivable. Many of the repayment provisions are conditional. Repayments may be required in some cases if property is sold, or if expected matching funds come through or if there is revenue of some kind associated with the project for which the grant was originally made. There are very few of these repayable grants to begin with. While the current system using the contract manager and project manager to enforce the payback provisions has worked in general, in some cases, for various reasons, public agencies and nonprofit organizations have not been able to repay portions of grants. In order to ensure centralization of the grant-repayment function, we will direct our contracts unit to bill grantees in accordance with the repayment schedule in the grant agreement. Copies of the billing will be provided to the contract manager and to the accounting unit, and follow up will be made if payment is not received within a timely manner.

Loan Repayments Recorded as Revenues in Conservancy Fund: Instead of putting repaid funds into the bond fund of origin the Conservancy has deposited these funds in the Coastal Conservancy Fund. This fund is used for general operations and support. The Conservancy claims that Section 31011 of the Public Resources Code requires it to place repaid funds into the Coastal Conservancy Fund, but Government Code Section 16303 requires that returned funds be credited to the originating appropriation and fund. Because the Conservancy and the Controller have not established separate accounts within the Coastal Conservancy Fund, it is hard to identify what money in that fund should be identified as bond funds. This has led to the improper use of bond funds, most notably \$37,000 of support costs, including \$10,000 for yoga classes identified in a 2006 audit. These funds had to be returned and other funds used instead.

Detailed response: The Conservancy does not "claim" that Section 31011 of the Public Resources Code requires that it place repaid funds into the Coastal Conservancy Fund. The statute says: "Unless otherwise provided in this division, any funds received by the conservancy pursuant to this division shall be deposited in the State Coastal Conservancy Fund." This section of the Public Resources Code was enacted after the enactment of Government Code Section 16303 and is more specific. Thus, if the two statutes were to conflict, section 31011 would normally prevail.

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We strongly disagree that bond funds were misused in that repaid funds were not identified as bond funds. First we disagree that repayments into the Coastal Conservancy Fund should always or perhaps ever be classified as bond funds. But in the unlikely event we are incorrect on this point and repaid funds are classified as bond funds, each of the bond funds that are the subject of this audit allows for their use for state administrative expenses. Additionally, repayments placed in the Coastal Conservancy Fund are subject to appropriation by the Legislature. They cannot be used for administration or any other purpose without the approval of the Governor and Legislature. The practice of putting repayments into the Coastal Conservancy Fund is well known by the Legislature and the Department of Finance and is part of the Conservancy's Long Term Financial Strategy that is updated and discussed by the Conservancy on a yearly basis in a public meeting. Whether repaid funds were returned to a bond appropriation or fund, or to the State Coastal Conservancy Fund, their use for administration was legal and anticipated in the language of the bond acts that generated this money.

The above is true even for the subsidized yoga classes from 2005/06. Rather than dispute that issue at the time it was raised in a previous audit, we decided to switch this expenditure to a non-bond support appropriation. But expenditures for these classes were nothing out of order. They were part of the Conservancy wellness program authorized pursuant to Executive Order W-119-95, which provides in part that core wellness programs, including exercise programs, shall be developed, and that every state department shall dedicate resources to Work Site Health Promotion. Of the \$8,360 which paid for these classes, \$3,822 was paid by staff contributions, leaving \$4,538 as the state's contribution for the 2005/06 fiscal year. It is well documented that exercise provides health benefits, and the cost of yoga to the state is considerably less than other state-recommended options such as subsidies to health club memberships. We consider it inappropriate that the audit brought up this finding from 2006 to justify the position on deposits into the Coastal Conservancy Fund.

Recommendations:

- A. Cite or obtain legislative authority and develop and implement a loan program accordingly.

Response: We have cited what we consider to be unequivocal statutory authority to seek repayments of grant funds.

- B. Identify and document all outstanding bond loan receivables. Record bond loans as receivables in the Conservancy's accounting system in accordance with SAM section 7622. Maintain supporting documentation for these amounts.

Response: We have identified all outstanding bond loan receivables. We believe that we are in compliance with the Conservancy's enabling legislation and applicable Government Codes and SAM sections.

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- C. Record bond loan repayments in the bond fund of origin. Discontinue depositing bond loan repayments in Fund 0565. Transfer prior bond loan repayments from Fund 0565 to the bond fund of origin. Maintain supporting documentation.

Response: We will continue to follow the law.

- D. Provide a corrective action plan.

Response: We will comply with this requirement as detailed above.

Observation 2: Project Awarding Process Needs Improvement: The Conservancy has authorized hundreds of millions of dollars without program guidelines, specific awarding criteria, project application forms, or website announcements in place. The Conservancy does not have a formal awarding process or a grant applications process to document its project merit review. The merit of projects is not transparent. The Conservancy's website does not have sufficient information to tell potential grantees of its priorities and funding opportunities. Projects under development are not included in project agendas. With the high number of Conservancy program staff and managers consistency cannot be ensured without more process for awarding grants. The Conservancy has not followed statutes and its own plans in developing program guidelines.

Detailed response: The Coastal Conservancy has a very successful track record, having funded well over 1,200 projects since its inception. The Conservancy's substantial record of success includes such accomplishments as: helping to protect more than 150,000 acres of wetlands, wildlife habitat, farmland, recreational lands and scenic open space; helping to build over 400 access ways and 100's of miles of trails such as the California Coastal Trail, the San Francisco Bay and Ridge Trails; assisting to complete over 100 urban waterfronts to reclaim properties for recreational use and economic development; and leading the planning and restoration for many complex stakeholder processes including the nationally significant San Francisco Bay Salt Pond Restoration project.

The Conservancy has formally adopted project selection criteria, and a formal, transparent awarding process that follows statute. The Conservancy marries these formal criteria and processes with hands-on involvement with prospective and awarded grantees to encourage innovation and excellence to the extent practicable within each project. The audit suggests problems where they do not exist and are unlikely to arise, and it fails to acknowledge the effectiveness of the processes in place. We assert that this is clearly a case of "if it ain't broke, don't fix it."

The Conservancy long ago formally adopted "Project Selection Criteria" in accordance with the requirements of Division 21, the Conservancy's enabling legislation, and has modified the criteria from time to time, most recently June 4, 2009. The Conservancy uses its project selection criteria, provisions of Division 21, bond-act criteria, Strategic Plan criteria, the occasional Budget Act criteria, and significant public input from stakeholder groups to identify important projects and make funding recommendations.

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Conservancy staff is entrepreneurial and geographically arrayed. As directed in Division 21 of the Public Resources Code, the Conservancy works with local and state government officials and nonprofit organizations to develop projects that meet state and regional goals. It generally does not institute grant rounds but instead has an open grant process. Applications can be and are made, and these are considered at any time. There are several advantages to a rolling application process. For example, prospective grantees do not have to prematurely submit an application before a project is adequately developed, and Conservancy staff can provide needed guidance to improve projects before the application is submitted. We believe that this process improves the quality of the applications received and ultimately of the projects that are funded.

These procedures are an efficient process for awarding grants that meets statewide and regional needs. Awards are made at open public hearings. The staff reports are detailed, including the rationale for the project and its priority, how it meets the requirements of the Conservancy's enabling legislation and funding sources, and how it meets both strategic plan goals and project selection guidelines. The public is invited to speak on each project and the Conservancy's board, by public vote, may modify or reject any proposal. This is a very transparent process.

With respect to the form of grant applications, based on discussions with the auditors, we have created a uniform grant application that is posted on our website. There is now more information available to the public concerning priorities and how to apply for funding.

The Conservancy has followed applicable statutes in the development of project selection criteria, the development of a strategic plan and five-year infrastructure plan, and in its compliance with bond act requirements. Proposition 50 requires new guidelines to be developed unless guidelines already exist that are sufficient. Conservancy guidelines predate the passage of this bond act. The bond act's sponsors were aware of the existence of the Conservancy's guidelines and placed the language in the measure in part so that the Conservancy did not have to develop new ones.

Recommendations:

- A. Develop program specific guidelines and criteria outlining the submission, evaluation, and project priority process and determination.

Response: We have updated the Conservancy's website with information helpful to potential grantees and have standardized our grant application. Given existing project selection criteria, the detailed language authorizing each program contained in Division 21 of the Public Resources Code, the specific language contained in various bond acts, and our strategic and infrastructure plans, we do not believe additional work in this area is warranted or an efficient use of scarce dollars or staff resources.

- B. Publish the above guidelines and funding opportunities on the Conservancy website.

Response: The website has been and will continue to be upgraded with new information.

- C. Document merit review activities clearly indicating how projects meet the program's established awarding criteria.

Response: This is already done in great detail in our staff reports.

- D. Provide related staff training.

Response: Conservancy staff is provided periodic training in-house in both formal and informal settings.

Observation 3: Project Matching Funds May Not be Maximized: In some cases it appears that the Conservancy has required matching funds but either grant contracts and work programs and budgets do not include this requirement, and/or requests for reimbursements do not include a way to track matching funds.

Detailed Response: In general Coastal Conservancy grants require that all funds needed to complete a project are in hand before Conservancy funds may be used. The amount of Conservancy funds in proportion to the overall cost of a project is negotiated prior to the project being brought for final approval by the Conservancy's board.

The Conservancy always seeks to ensure that any project it funds has multiple funding sources. The Conservancy funds a greater portion when applicants have limited funds available for high priority projects, but on balance, our project funds are well leveraged. Between 1987 and 2009, Conservancy funds were matched with non-state funding by nearly 2-1. We will continue to leverage funding to the extent practicable.

The staff reports and resolutions brought to the Conservancy describe the various funding sources that will be used to complete a project, but usually do not require a specific match either in cash or in-kind services. The requirement is that the project be completed, and that Conservancy funds do not surpass a specified amount. The audit mistakenly interprets various sections of staff reports which describe expected sources of funding, as required matching funds. They are not requirements unless specific, mandatory language is included in the resolution approving the Conservancy's grant. As a result of the audit we have adopted more standard "matching fund" language for our staff reports to clarify.

Recommendation: Monitor and verify match contributions prior to disbursement. Include a match reporting section in the reimbursement request form and require submission of match documentation.

Response: Conservancy staff works with grantees before projects begin to ensure that funding is available to complete the project and that the cost estimates for each project are accurate. Our chief goal

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is to ensure that the project is completed as described. We are less concerned whether or not a grantee provides a set amount of funds as opposed to in-kind services to get the job done, or whether the grantee changes funding sources during the project. Since we generally do not have set matching fund requirements, there is no value added in requiring documentation other than that detailing that the project has been completed as contracted. This is done through an end audit of each project.

Observation 4: Project Fiscal Oversight Needs Improvement: The Conservancy lacks adequate project fiscal oversight. Based on a review of 12 projects, the following control weaknesses were noted:

The Conservancy does not agree with this finding. The Conservancy received audit reports for only seven of the nine projects listed in Appendix C. Of the \$17,855,138 audited in those seven reports, the auditors questioned only \$78,645 in expenditures. Upon review, those expenditures were found to be appropriate. The specific contract did not reference an agreed upon rate schedule, and the file lacked complete documentation, but we do not agree that this constituted a lack of adequate fiscal oversight. Nonetheless we have ensured that these corrections have been made since we take our fiscal responsibilities very seriously and we are proud that the vast majority of our project audits have found no problems at all.

Detailed Responses

- Detailed work plans and budgets are not consistently received or documented prior to project commencement.

Response: Invoices are not paid without detailed work plans and budgets being part of a contract file. Initial review of invoices is conducted by our contract staff, who do not forward them to our project and accounting staff if work plans and budgets are missing.

- Grantee reimbursements are not consistent with grant budgets.

Response: This issue concerns overhead payments made to the Sonoma Land Trust that the auditors claim were not authorized by the contract. However, as we explained to the auditors in a memo, there was an agreement negotiated between our North Coast Program Manager and the Executive Director of the Land Trust that authorized 15% overhead for all contract items. It is worthwhile to note that this agreement was reached within the context of a larger negotiation, initiated by the Conservancy, regarding the billing rates of the Sonoma Land Trust. This negotiation resulted in a substantial rate reduction, nearly 50% for their Executive Officer and other staff. These negotiated rates were also memorialized in an email, but not transferred to a formal agreement or placed in the contract file. We disagree that overhead payments were not authorized.

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- The Conservancy lacks formal monitoring procedures, leading to inconsistent reviews and limited documentation.

Response: We have now established a project-monitoring process that will be documented in our project database. As for the Malibu Lagoon Restoration project, amendments do not lack documentation. These amendments were authorized by the Conservancy's board. The grant agreement amount was increased to fund subsequent phases of a complex project, not to cover cost overruns, and there is a detailed work program for each amendment.

- Post-close monitoring is not performed.

Response: Post-close monitoring has been accomplished informally during visits of the project managers to their geographic areas. Most of the conservation easement acquisitions that we have funded already have monitoring requirements. We are now implementing a formal monitoring system for other projects.

- Project status is inaccurate and incomplete.

Response: As noted, we are behind in entering data into the bond database. This is due to lack of staff resources in part due to required furloughs. Additional resources have been assigned to this task.

Recommendations:

- A. Develop a standard application with workplan/budget templates including directions on how to complete it. Define the level of detail needed for different project types to ensure consistency among the program staff.

Response: We have developed a standard grant application that is now in use. We have templates for workplans and budgets and use them where it makes sense. The Conservancy funds many types of projects, and these templates do not work for all projects.

- B. Standardize reimbursement forms to match the approved grant budgets. Include templates in program guidelines along with clear definition of eligible costs.

Response: We have a standard reimbursement form that has been used for years, and we have now made use of that form mandatory for all projects. We have guidelines related to overhead and indirect costs.

- C. Develop and implement monitoring procedures outlining site visit intervals, areas to review, and project documentation required.

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Response: We have developed procedures to accomplish this. We are in the process of training staff and implementing these procedures.

- D. Require grantees to submit a maintenance and operation plan at project close-out and require periodic project condition reports.

Response: Maintenance and operation requirements are included as conditions of grants or as contract terms when warranted. They are not apposite to all types of projects or needed in all cases. The periodic condition of projects will be monitored through the new process.

- E. At year-end, reconcile project database information to accounting records to ensure all bond projects are accurately recorded. Complete the Coastal Project Management Database and update the website accordingly.

Response: This is in process.

Thank you for the opportunity to respond to the audit of Conservancy administered State bond funds.

Sincerely,

Original signed by:

Samuel Schuchat
Executive Officer
California Coastal Conservancy

EVALUATION OF RESPONSE

The Conservancy's response to the draft audit report has been reviewed and incorporated into the final report. In evaluating the response, we provide the following comments:

Observation 1

The Conservancy states that grants with repayment provisions are not considered loans and therefore should not be recorded as a receivable. However, irrespective of the type of financial instrument, loan or grant, the transaction should be recorded as a long-term receivable due and payable to the state within the originating fund. Proper accountability is necessary to ensure bond funds are separately tracked for future use and reappropriation.

In addition, based on subsequent consultation with bond counsel at the State Treasurer's Office (STO) and pursuant to the attached September 11, 2008 memorandum, there could be additional reporting requirements and potential tax implications. We strongly recommend the Conservancy consult with the STO and Finance's Fiscal Systems and Consulting Unit (FSCU) to determine specific recording and reporting requirements.

Please provide us a Corrective Action Plan within 60 days of this report including the final resolution based on consultation with the STO and FSCU.

Observation 2

In response to this finding, the Conservancy created a grant application form and posted it on their website. However, we continue to recommend program-specific guidelines and program-specific criteria for the submission, evaluation, and awarding of grants.

Observation 3

The Conservancy has taken steps to address this observation by clarifying definitions and adopting more standard "matching fund" language for its staff reports. In those instances where match is required, the Conservancy should implement procedures to verify and document matching contributions.

Observation 4

Although the Conservancy does not agree with this finding, it has taken corrective actions. In addition, at the time the draft report was issued, two grant audits were still in progress. To date, all grant audits listed in Appendix C have been completed and issued.

M E M O R A N D U M

Date: September 11, 2008

To: General Obligation Bond Program Administrators

From: Geoff Palmertree, Manager
Interim Finance Section
Public Finance Division
State Treasurer's Office

Subject: Returned Grant Funds

Departments that administer grant¹ programs funded by general obligation bonds occasionally have grant funds returned by the grantee. This memo is intended to answer frequently asked questions concerning departments' obligations in such situations.

Should the department notify the State Treasurer's Office (STO)? Yes. The Tax Compliance Certificate executed by each department requires the department to immediately notify the STO when grant funds are returned to the department. Returned grant funds are considered unspent bond proceeds, which must be tracked in order for the State to comply with federal tax law requirements.

What information should the department provide to the STO? The following information should be provided to the STO:

- Date the original grant was made
- Amount of the original grant
- The name of the bond act and the number of the bond fund from which the grant was made
- Date and amount of grant funds returned
- Plan for re-granting the funds

What should the department do with the returned grant funds? The returned grant funds should be placed in the bond fund from which the original grant was made and re-granted as soon as possible. If the returned funds can be re-granted and disbursed within 60 days, the STO will not need to track interest earnings on the funds. If the returned funds are not re-granted and disbursed within 60 days, the STO will engage the State's arbitrage rebate consultant to perform the necessary calculations until the funds are re-granted and disbursed. Please notify the STO of the date on which the funds are re-granted and disbursed.

¹ A grant is a transfer of money for a specific purpose, without any obligation or condition to directly or indirectly repay any amount. However, a condition requiring a grant to be returned if the grantee does not meet the requirement of the grant (e.g., a change in use of the project, or if the project is completed under budget) does not prevent the transfer from being a grant.

Immediately notify the STO if for any reason the department will be unable to re-grant the returned funds.

Should the department establish a written policy regarding re-granting of returned grants? Yes. The STO recommends that the department establish a formal written policy providing that all returned grants will be the first dollars disbursed for other eligible grants so long as the necessary appropriation is in place.

What if the returned grant includes some sort of penalty or is otherwise in excess of the original grant amount? Any returned amount in excess of the original grant is not considered bond proceeds and does not need to be tracked for federal tax law purposes. However, a variety of State laws could apply and govern the use of moneys derived from or associated with bond proceeds. These laws could include the bond act itself, laws applicable to a particular program or recipient, and other laws and regulations. The STO recommends that the department consult their legal counsel or the Attorney General's Office in such situations.

What are the record retention requirements for the returned grants? Records relating to a general obligation bond funded grant program, including those related to a returned grant and the subsequent re-granting of the funds, must be retained for 35 years from the date of the original grant. See the July 2, 2008 memo from the STO regarding records retention for additional information.

We hope the above information is helpful. If you have any questions that are not addressed by this memo, please contact Melinda Chan at mchan@treasurer.ca.gov or (916) 653-3445.